DEPARTMENT OF STATE REVENUE
LETTER OF FINDINGS NUMBER: 99-0651
Sales Tax
For Years 1991-1998

NOTICE: Under Ind. Code 4-22-7-7, this document is required to be published in the Indiana Register and is effective on its date of publication. It shall remain in effect until the date it is superceded or deleted by the publication of a new document in the Indiana Register. The publication of this document will provide the general public with information about the Department's official position concerning a specific issue.

ISSUES

I. **Sales Tax – Imposition of Gross Retail Tax on Sales of Software**

Authority:		
	IC § 6-2.5-1-2(a)	**45 IAC 2.2-1-1(c)**
	IC § 6-2.5-1-8	**45 IAC 2.2-2-1**
	IC § 6-2.5-2-1	**45 IAC 2.2-2-2**
	IC § 6-2.5-4-1	**45 IAC 2.2-4-1**
	IC § 6-2.5-4-2	**45 IAC 2.2-4-4**
	IC § 6-2.5-5-4	**45 IAC 2.2-4-27**
	IC § 6-2.5-5-8	**Sales Tax Information Bulletin # 8**

Taxpayer protests the imposition of gross retail tax on sales of "canned" software made to one specific customer.

II. Tax Administration: -- Penalty

Authority:		
	IC § 6-8.1-10-2.1	**45 IAC 15-11-2**

Taxpayer protests the imposition of the 10% negligence penalty.

STATEMENT OF FACTS

Taxpayer is a corporation registered in the state of North Carolina as a retail merchant. Taxpayer sells, among other items, software packages to various businesses which engage in charitable financial planning, e.g., setting up trusts, annuities, and the like. As a registered retail merchant in North Carolina, taxpayer pays gross retail tax in that state only. The Department audited taxpayer after auditing one of taxpayer's customers, an Indiana corporation (hereinafter "customer"). Customer's audit resulted in the imposition of gross retail tax liability for tax years 1991-1994, and customer successfully protested the audit. The Department, based on a letter submitted by taxpayer

outlining an agency relationship, found that customer was acting as an agent of taxpayer in order to sell software to end customers. The Department therefore found that customer was not ultimately liable for the gross retail tax that should have been collected and remitted on the purchasing transactions.

Thereafter, the Department audited taxpayer and determined that taxpayer was liable for the Indiana gross retail taxes for tax years 1991-1998. The Department also imposed the 10% negligence penalty. Taxpayer timely protested the results of the audit and a hearing was held on March 28, 2001 by telephone conference. Further information will be added as necessary.

I. Sales Tax: Imposition of State Gross Retail Tax on Computer Software

DISCUSSION

Taxpayer protests the imposition of Indiana's gross retail (sales) tax on its retail sales of computer software packages to Indiana customers. Taxpayer contends these computer software packages were not transferred in retail transactions; but rather the packages were sold to an Indiana retailer (customer) which subsequently resold them. Taxpayer argues that its customer, the retailer, is liable for the sales tax liabilities—not taxpayer, the customer's wholesale supplier.

At the hearing, taxpayer (a software retailer and developer), stated that two of customer's executives flew to North Carolina with a business proposition for taxpayer: since customer was good at business administration and taxpayer was good at developing software, customer and taxpayer should do business together. Customer wanted to use taxpayer's existing proprietary software, but also wanted special programming added for annuities and other complex charitable financial planning transactions. Customer gave taxpayer specifications and taxpayer created a computer software package.

Taxpayer also stated at the hearing that customer held training seminars lasting up to 4 days, charging each attendee up to $5,000. According to taxpayer, customer purchased the software packages from taxpayer for $595 each, resold them to attendees for $695 each, remitting the purchase price to taxpayer and keeping the difference.

Simply stated, the issue in this protest concerns the nature of the business relationship between taxpayer and customer. Is taxpayer supplying software packages to customer for resale, or is taxpayer itself engaged in retail transactions?

Generally speaking, the retail transactions of retail merchants are subject to Indiana's gross retail tax as set forth in IC §§ 6-2.5-1-1, 6-2.5-1-2(a), 6-2.5-1-8, 6-2.5-1-1(a), (b)(1)(2) and (d), 6-2.5-4-1 and 4-2(a)(b)(1). Exemptions from the gross retail tax can be found at 6-2.5-5-4 and 5-8. *See also*, 45 IAC 2.2-1-1(a), 45 IAC 2.2-2-2-1, 45 IAC 2.2-2-2,45 IAC 2.2-4-1 and 4-4. In the normal course of business, a computer software design firm creates a package, licenses it for "sale," and provides maintenance agreements for software upgrades. The Department has issued Information Bulletins concerning software packages.

Sales Tax Information Bulletin # 8, revised and published in 1990, discusses the application of the gross retail tax to the sale, lease, and use of computers and computer related equipment. With respect to transactions involving computer software, Bulletin # 8 provides in pertinent part:

> As a general rule, transactions involving computer software are not subject to Indiana Sales or Use Tax provided the software is in the form of a custom program specifically designed for the purchaser.
>
> Pre-written programs, not specifically designed for one purchaser, developed by the seller for sale or lease on the general market in the form of tangible personal property and sold or leased in the form of tangible personal property are subject to tax irrespective of the fact that the program may require some modification for a purchaser's particular computer. Pre-written or canned computer programs are taxable because the intellectual property contained in the canned program is no different than the intellectual property in videotape or a textbook. (emphasis added)

In summary, transactions involving "canned" software are taxable; those involving "custom" software are not. The evidence now presented by taxpayer—testimony, purchase orders and invoices—suggests that taxpayer was a supplier of software that its customer subsequently sold. However, this same issue (i.e., the relationship between who sells the software to ultimate users) was addressed in the prior Letter of Findings 4 years ago. At that time, the customer presented a letter from this taxpayer indicating that customer was acting as an agent for taxpayer in its transfer of software to ultimate users, the seminar attendees. In the absence of facts supporting a change in their relationship, taxpayer cannot now come forward and claim customer is no longer its agent.

FINDING

Taxpayer's protest concerning the imposition of sales tax on sales of computer software is denied.

II. Tax Administration – Penalty

The taxpayer protests the Department's imposition of the 10% negligence penalty.

Indiana Code 6-8.1-10-2.1(a)(3) authorizes the Department to impose a penalty on a taxpayer if he "incurs, upon examination by the department, a deficiency that is due to negligence." Subsection (d) provides in pertinent part:

> If a person subject to the penalty imposed under this section can show that the failure to . . .pay the deficiency determined by the department was due to reasonable cause and not due to willful neglect, the department **shall** waive the penalty.

(Emphasis added)

Indiana Administrative Code, Title 45, Article 15, Rule 11-2(b) provides in pertinent part:

> "Negligence" on behalf of a taxpayer is defined as the failure to use such reasonable care, caution, or diligence as would be expected of an ordinary reasonable taxpayer. Negligence would result from a taxpayer's carelessness, thoughtlessness, disregard or inattention to duties placed upon the taxpayer by the Indiana Code or department regulations. Ignorance of the listed tax laws, rules and/or regulations is treated as negligence. Further, failure to read and follow instructions provided by the department is treated as negligence. Negligence shall be determined on a case by case basis according to the facts and circumstances of each taxpayer.

In determining whether or not to assess the 10% penalty, the Department looks for indicia of negligence as well as indicia of due diligence. Taxpayer did not present any evidence, arguments, or documents, which would show due diligence on taxpayer's part to discover its tax liabilities for doing business in Indiana. Since ignorance of Indiana's tax laws is treated as negligence, the penalty stands.

FINDING

The taxpayer's protest concerning the imposition of the 10 % negligence penalty is denied.

DF/PE/MR 011008